

CHAPTER 1

INTRODUCTION

1.1 Background of Study

The origins of adjudication go back to the 1970s when it was introduced for a limited purpose in the construction industry between main contractor and sub contractor. At that time there were complaints that the main contractors were defaulting their payments to the sub contractors on the account of spurious claims of delay. After the case of *Modern Engineering (Bristol) v Gilbert-Ash (Northern)*¹, the construction industry decided that for a main contractor to withhold payments to a sub contractor, he must notify the sub contractor of an intention with the ground of defense, set-off or counter-claim. Only then if dispute arises, it will be referred to an adjudicator, who will decide whether the amount disputed will be withheld or paid.

The history of Statutory Adjudication can be traced to the introduction of the Housing Grants Regeneration and Construction Act 1996 (HGCRA 1996) which came into force in the United Kingdom in May 1998 pursuant to Sir Michael Latham reports “Constructing the Team” in 1994 which reported the woes of the UK’s

¹ (1974) AC 689

construction industry. In his report, Sir Michael Latham recommended among other things that ‘a system of adjudication should be introduced within all standard forms of contract and that this should be underpinned by legislation’. This recommendation therefore led to the move from consensual adjudication to statutory adjudication.

This was followed by New South Wales, Australia with the Building Industry Security of Payments Act 1999. Since then, the legislation has come into force in New Zealand, Victoria, Queensland, Western Australia and finally Singapore (Building and Construction Industry Security of Payment Act 2004) in April 2005.

Lord Denning in his now famous judgment in the Court of Appeal in *Dawnays Ltd v Minter Ltd*² has this to say about construction disputes:

“There must be cash flow in the building trades. It is the very lifeblood of the enterprise”.

In his usual vintage style, Lord Denning did not mince his words in criticizing the frustrating effects of a long-drawn dispute resolution process, unfortunately common to construction disputes due to its complexity:

“One of the greatest threats to cash flow is the incidences of disputes, resolving them by litigation is frequently lengthy and expensive. Arbitration in the construction industry is often as bad or worst”.

Ask any contractor what is his constant headache or fear is and he will lament that it is not about being able to do a good job or getting the building built but the endemic problems of poor payment practices. These place unwarranted hurdles to

² (1971) 1 WLR 1205

cash flowing smoothly downstream through the whole construction chain. In Malaysia, it is not uncommon to read press reports on the woes and cries from main contractors, subcontractors and suppliers on the shortcomings of the payment regime in the Malaysian construction industry. Nevertheless, such practices were never an issue during good times when jobs were aplenty and many contractors or even subcontractors will tolerate late payments or even part payments. However, these problems will magnify when the construction industry is deeply scathed by bleak market sentiments and falling construction demand.

Several countries have enacted the legislation on Adjudication to ensure that regular and prompt payments for works under the contracts in the construction industry – to maintain progress payments under dispute. Under the legislation – claimants who provided works, goods and services can force the respondent to make payments on account. The scheme is thus a process which enables a dispute to be quickly decided on a provisional or interim basis. The scheme also provides for the Adjudicator's decision to be immediately enforceable subject only to the final determination of the dispute in arbitration or litigation.

The obvious attraction of the process of Adjudication is that it is a fairly quick process in comparison to arbitration or litigation. Whilst the objective of various Construction Contracts or Payment related Acts is consistent, the legislations in various jurisdictions lack uniformity, for instances, from the Notice of Referral, the Adjudicator has 28 days in United Kingdom, 10 working days in New South Wales, Australia, 20 days in New Zealand and 14 days in Singapore, to render a decision. Once the Adjudicator's decision has been rendered, the winning party can enforce it summarily in the Court if the losing party refuses to comply with the Adjudicator's decision.

Therefore, the robustness of the Courts in dealing with jurisdictional challenges and the Court's willingness to enforce the Adjudicator's decision by way

of summary judgment must certainly have contributed to the enormous growth and widespread use of Adjudication.

Statistics from United Kingdom has been encouraging. Since the implementation of Housing Grants Regeneration and Construction Act 1996 on May 1998, over 7500 cases have been referred to Adjudication and only 195 cases have been challenged in the Technology and Construction Court or TCC. It is undoubtedly an awesome record to have only about 2.6 percent of the Adjudicator's decisions being challenged in the Court.

In response to the growing concerns about cash flow problems, which are frequently encountered by main contractors, sub-contractors, suppliers in the construction industry in Malaysia, the construction industry, spearheaded by Construction Industry Development Board (CIDB) and Institute Surveyors Malaysia (ISM), is actively advocating the legislation on Adjudication in Malaysia. The enactment of the Adjudication Act will introduce new developments in our law. For instance, it provides for entitlement to progress payments to main contractors, sub-contractors, and suppliers in construction and supply contracts and perhaps the consultants, even if no such entitlement is provided in their contracts. What is more important is that the commonly used 'pay when pay' provisions in construction contracts will be unenforceable.

Statutory adjudication imposes prescriptive time limits to make payments and provides for an effective fast track adjudication to resolve payment disputes and the right to suspend work amongst other remedies where the adjudicated amount is unpaid. In short, it is about getting paid on time and in the amounts rightfully due.

Nevertheless, there is some misconception surrounding the use of adjudication namely that adjudication delivers ‘rough justice’³. The issue which arises is the extent to which adjudication conducted under the intense time pressures and within the limitations envisaged for the process under the present legislations can be expected to observe the rules of fair play which are normally described as “natural justice”. Judge Bowsher QC in his judgment in the case of *Discaint Project Services Ltd v. Opecprime Ltd*⁴ observed the following:

“... [One] has to recognize that the adjudicator is working under pressure of time and circumstance which makes it extremely difficult to comply with the rules of natural justice in the manner of a Court or an Arbitrator”.

This research thesis is intended to provide a better understanding on the process of Adjudication to all practitioners in the Malaysia construction industry. More importantly, focus is given to determine the relevance of the principles of natural justice in adjudication. This paper is written based on a research on relevant decisions of the courts of United Kingdom and Australia, where the courts have interpreted provisions in their legislations that could be used as a useful guide and a valuable point of reference.

1.2 Problem Statement

It has been suggested that, while the manner by which the principles of natural justice apply to arbitration and court proceedings have been well established, it may be unrealistic to expect adjudicators acting under severe time constraints in the context of the legislations to comply with these principles to the same extent.

³ Refer to the rough nature of its process; see Judge Humphrey Lloyd’s judgment in *Balfour Beatty Construction Ltd v Lambeth London Borough Council* (2002) EWHC 597.

⁴ (2000) BLR 402

Given that adjudication is but an imperfect mirror of arbitration in terms of objectives and hence the very nature of the processes involved, to what level of compliance to the principles of natural justice is expected of an adjudicator?

Humphrey Lloyd QC J in his judgment in the English case of *Balfour Beatty Construction Ltd v Lambeth London Borough Council*⁵, concurred that,

“principles of natural justice applied to adjudication may not require a party to be aware of the case that it has to meet in the fullest sense since adjudication may be inquisitorial or investigative rather than adversarial”

Judge Bowscher QC in his judgment in the case of *Discaint Project Services Ltd v. Opecprime Ltd*⁶ observed the following:

“... [One] has to recognize that the adjudicator is working under pressure of time and circumstance which makes it extremely difficult to comply with the rules of natural justice in the manner of a Court or an Arbitrator. Repugnant as it may be to one’s approach to judicial decision-making, I think the system created by the (HGCRA) can only be made to work in practice if some breaches of the natural justice which have no demonstrable consequence are disregarded”.

Duncan Wallace, the learned editor of Hudson, called the HGCRA Act 1996, ‘pro-producer’, ‘anti-customer’ and ‘anti-paymaster biases’⁷.

⁵ (2002) EWHC 597

⁶ (2000) BLR 402

⁷ (2000) 16 Const LJ 102

1.3 Objective of the Study

The concept of “natural justice” is normally understood in relation to the fairness of the procedures adopted for arbitration or courts proceedings. The primary objective of this research is to determine the relevance of the principles of natural justice in adjudication. This research is intended to enhance the confidence of practitioners in the Malaysian construction industry on the use of Adjudication in the construction industry as an effective alternative dispute resolution despite the rough nature of the process.

1.4 Scope and Delimitation of the Study

This paper seeks to discuss the various dispute resolutions that are being practiced in the Malaysian and around the world namely, litigation, arbitration, mediation, adjudication, med-arb, conciliation, early neutral valuation, and dispute board.

This research will review the existing legislations on adjudication. This research will also review the relevant published case law on adjudication and discussed the relevant decisions of the courts on the subject of the principles of natural justice.

As the adjudication act has yet to be enacted in Malaysia, this research shall be limited to the relevant decision of the courts from countries that have enacted the act.

1.5 Research Methodology

The methodology of this research is by way of literature review. Much has been written on the topic on adjudication and many books have been published on the regime under the adjudication act of various jurisdiction. This research will review those regimes and their provisions on the subject of the principles of natural justice.

This research will also review the relevant case law with regards to adjudication and seek to investigate the interpretation of the principles of natural justice in adjudication by the courts. Case law journals are readily available through the Lexis-Nexis database via the Internet.

Since this research is by way of literature review only, no surveys will be conducted. Therefore, the views and sentiments of those affected parties shall be based on the books and journals that have previously written.

1.6 Previous Research

An extensive research was done by Sir Michael Latham and his report “Constructing the Team” (1994) was the backbone to the construction of the UK’s Housing Grant and Construction Regeneration Act 1996.

Many books have been published on the regimes of the respective countries’ Adjudication Act. Many journals were also published on this topic. This research

will also review all the relevant court decisions on the issue on the principles of natural justice.

1.7 Significance of the Study

Malaysian construction industry is proposing to the Government on the enactment of the Adjudication Act. Once the Act is adopted, it will introduce a totally new regime of claims, adjudications and enforcement procedures (including the right to suspend works and to exercise a lien on goods supplied) in the event of non-payment, all quite unfamiliar to the Malaysian construction industry. In the light of the tight timeframes and repercussions of the proposed Act, it is necessity for every practitioner in the construction industry to familiarize themselves on the subject of adjudication and its processes.

Adjudication is constrained especially by the time within which a decision is required. Given that, construction dispute is known to be usually complex in nature, it will be a tall order for an adjudicator to meet the time constrain yet observe the principles of natural justice as seen in arbitrations and litigations. Failure to comply could then be the cause of the adjudicator's decision being challenged.

It is therefore, important to determine the level of compliance of the principles of natural justice in the adjudication process as this will help to instill confidence on the part of practitioner when adopting the system.